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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

APR 12 1996

In the Matter of	)	
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Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
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COMMENTS

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SUMMARY

The Commission should prescribe an independently administered universal service fund, equitably supported by every provider of interstate telecommunications services, and available to all designated common carrier providers of line service. The purpose of this fund would be to provide dedicated support of basic service for low-income residential customers and residential customers in high-cost areas. Surveys of consumers and carriers should prove to be a reliable mechanism for determining demand for basic telecommunications services.
A market-based definition of services subject to universal service support will protect all customers. TCG supports the definition of basic service proposed in the Notice.

It would be unfair and contrary to the Act's goal of encouraging robust competition to require new entrants and startups to contribute to the fund from their already small revenue streams, particularly given that new start up competitors often take time to even become profitable. TCG recommends, therefore, that the Commission adopt a threshold market share of at least 1% of interstate net transmission revenue before a carrier is required to contribute to universal service funding.

The universal service mechanism should reply as much as possible on the forces of competition to maximize efficiency and consumer choice. Key to these goals is a distribution mechanism that allows all customers, including subsidized customers, to take full advantage of the competitive choices available to them. To achieve such goals, therefore, TCG recommends that the

Commission distribute support to carriers via a credit to the carrier for each customer that it serves eligible for support.

Independent administration of the fund is critical to the success of this endeavor. The Commission should put the administration responsibility out to bid. The administration contract should be no longer than three years and the administrator's compensation should be part of the total funding requirement assessed on contributors to the fund.

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COMMENTS

Teleport Communications Group Inc. ("TCG") hereby offers the following comments in response to the Commission's Notice of Proposed Rulemaking regarding the above-captioned proceeding. TCG's comments are limited to those topics with which we are familiar and with which we have particular interest. Additionally, TCG recommends that the Commission initiate a "Phase II" of this proceeding to investigate advanced universal services for schools, libraries, and rural health care providers. Such an approach would permit the Commission, the Joint Board, and all interested parties to devote proper attention to all of the universal service issues raised by the Telecommunications Act of 1996, while giving early attention to the broader policy issues necessary for local competition to develop.

I. INTRODUCTION

The passage of the 1996 Telecommunications Act ("Act") has created the possibility of viable long term effective competition in the local telecommunications marketplace. In addition to requiring cost-based interconnection and removing barriers to entry, the Act requires reform of the existing universal service mechanisms. To ensure that "consumers in all regions of the Nation, including low-income consumers, and those in rural, insular, and high cost areas, ... have access to telecommunications and information services...,"[1] the Act clearly directs the FCC to develop a mechanism that is consistent with achieving the Act's goal of effective facilities-based telecommunications competition. Furthermore, the Act establishes firm parameters for such a mechanism and directs the Commission to develop a process that will take advantage of the forces of competition. This Commission's decision will also be the model for complementary state universal service mechanisms.

The Act directs the Commission to implement a mechanism with the following features:

- Equitable and non-discriminatory contributions from all telecommunications providers [sec. 254 (b)(4)];
- Specific, predictable, and sufficient federal and state support mechanisms [sec. 254(b)(5)];
- Explicit support for the provision of basic service [sec. 254(d)]; and
- Support that is available to any carrier advertising and willing to provide service throughout a state-designated area over its own facilities or some combination of its own facilities and those of another carrier [sec. 214(e)].

These parameters clearly render the current federal Universal Service Fund ("USF") and the Dial Equipment Minutes ("DEM")

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[1]Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("the Act"), sec. 101(a), § 254(b)(3).

weighting program incompatible with the Act. Each of these programs provides funds only to incumbent local exchange carriers, and each is supported by contributions from only one segment of the industry. Furthermore, because support from these programs is not targeted in any way, but only goes to support the incumbent local exchange carrier's bottom line," it cannot be considered "explicit" and therefore cannot continue. Similarly, state programs that parallel these existing federal mechanisms are also incompatible with the Act, as are any mechanisms that do not equitably and fairly require contributions from all carriers, and that do not provide direct explicit support for basic universal service to eligible telecommunications carriers.

The solution that satisfies all the requirements of the Act is an independently administered universal service fund, equitably supported by every provider of interstate telecommunications services[2], and available to all designated common carrier providers of basic service for the explicit and dedicated support of basic service for low-income residential customers and residential customers in high-cost areas[3]. TCG has advocated this mechanism for a number of years now [4] and believes that circumstances warrant its immediate adoption by the

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[2]Id. Sec. 101(a), §254(d)

[3]Id. Sec. 102(a), §214(e), and Sec. 101(a), §254(b)(3)

[4]See, *Universal Service Assurance: A Concept for Fair Contribution and Equal Access to Subsidies*. Teleport Communications Group, December 1993.

Universal Service Assurance II: A Blueprint for Action. Teleport Communications Group, November 1994.

Commission. In the discussion that follows, TCG details the mechanics of such a program, the implications for separations, the issue of affordability, and the impact on the availability of telecommunications services.

II. DISCUSSION

A. Definition of Basic Service[5]

The key attributes of basic service are access and connectivity. "Basic service" represents the minimum level of service to which all consumers should have access. According to Sec. 254(c)(1) of the Act, the Commission must consider four fundamental factors to determine whether a particular service should be included in the definition of basic service eligible for support:

- essential to education, public health, or public safety;
- has been subscribed to by a substantial majority of residential customers through the operation of market choices;
- current status of deployment in public telecommunications networks by telecommunications carriers;
- consistent with the public interest, convenience, and necessity.

These criteria are necessary and sufficient to ensure that the definition of basic service will ensure that all households have affordable accessibility and connectivity to the public switched telecommunications network. Furthermore, they will ensure that they definition of basic service does not act as a barrier to

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[5]See Notice, paragraphs 15-23.

entry, nor create an undue financial burden for contributors to the universal service fund.

TCG emphasizes the importance of consumer demand in the determination of what should be included in the basic service. A service that has been selected voluntarily and paid for by a substantial majority of all non-subsidized residential subscribers in a market or service territory probably can be offered to all customers without placing an unreasonable cost burden on other customers or carriers.

As the telecommunications industry moves toward more competition, consumer demand will be a much more accurate barometer of the services that are considered truly basic and will ensure that the definition of basic service will evolve properly.[6] It is a simple matter to determine penetration levels of various services via periodic statistically valid surveys of households. Another way to obtain the data is to survey the providers themselves as to the penetration levels of the various services they offer. To protect the privacy of the surveyed households and to ensure that sensitive marketing data is not disclosed to competitors, surveys would have to be conducted under strict confidentiality. Surveys of consumers and carriers should prove to be a reliable mechanism for determining demand for, and expectations of, the telecommunications network.

To the extent that some telecommunications services enhance public health and safety, those services should become part of

[6]See Notice, paragraphs 66-67.

basic service only if their cost is reasonable and if they provide a clear social benefit. Certain emergency service numbers, such as 911 and E-911, are reasonably included in the definition of basic service (in areas where state or local government requires the provision of these services). Remote alarm services, by contrast, do not fall into the general category of services that have been selected by a "substantial majority" of residential customers, nor are they necessary for public safety. By allowing consumers to decide what economically constitutes basic service, regulators can be assured that basic service remains relevant and within the means of all consumers, without unduly burdening other consumers, carriers, or contributors to a universal service support fund. A market-based definition of services subject to universal service support will protect all customers from paying for services they do not want, while ensuring that all residential customers have access to services that are defined by the market as "basic." Accordingly, TCG supports the definition of basic service proposed in the Notice.

B. The Cost of Basic Service[7]

Because the estimates of the cost of universal service support vary widely, some uniform guidelines are in order so that all carriers are on a fair playing field, and so that the rules are consistent nationally. As a provider of local telecommunications services throughout the country, TCG

[7]See Notice, paragraphs 27-39.

appreciates consistent national rules to guide its operations in various states. TCG recommends, therefore, that the Commission adopt Total Service Long Run Incremental Cost ("TSLRIC") as the national standard for universal service cost estimates. TSLRIC measures the true economic cost of providing basic service, independent of any particular provider, and will guarantee that market entry by would-be competitors will be economically efficient. Other cost measures, like the embedded costs used for the USF and DEM programs, could encourage entry by inefficient competitors whose costs are less than the embedded costs of the incumbent but more than the incumbent's long run incremental cost of providing service. The universal service mechanism should encourage only efficient market entry.

Any TSLRIC model adopted by the Commission must be independent of any provider, must be technology-neutral, must be open to public scrutiny and review, and must be subject to revision via more accurate input data or more sound modeling parameters. Of the two models identified in the Notice for which the Commission requests comment, TCG believes that the Benchmark Cost Model offers greater promise, in large part because it is publicly available and relies upon publicly available data.

While the BCM is not without its shortcomings, TCG believes these shortcomings are generally identifiable and potentially correctable. For example, as the Notice points out, because the BCM excludes business lines from its calculation. Thus, its results fail to capture the scale economies that their inclusion might provide, resulting in an overestimate of the cost of basic service. In addition, because the BCM uses one rate for labor throughout the nation, in every Census Block Group ("CBG"), it may overestimate the cost of basic service in areas where the labor rate is less than the assumed rate. Finally, as the mentioned in the Notice, the BCM assumes that all customers are evenly distributed throughout the CBG rather than concentrated around a town/city center as might be the case in reality. This assumption would also serve to inflate the cost of providing basic service in rural areas where only a small portion of the lines are in sparsely populated areas and the rest are concentrated close to the "ideal" location of the central office. In any event, because it is public, the BCM's shortcomings can be identified and corrected.

The proxy cost model developed by Pacific Telesis ("PacTel"), on the other hand, is proprietary and so has not been subject to detailed scrutiny. It also has been available a much shorter time. Thus, its strengths and weaknesses are not as apparent at this stage as are the strengths and weaknesses of the BCM. The Notice points out that one strong point of the PacTel model is that it permits greater or lesser aggregations of data. That is, the analysis can be done at the wire center, CBG, or individual line levels.[8] TCG in not aware, however, that this

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[8]The objective in establishing relatively small cost study areas is to minimize the cost variation between customers in any particular area so that opportunities for cream-skimming are minimized. To the extent that costs do not vary significantly within a wire center, then wire centers may be an acceptable

flexibility is unique to PacTel's model or that similar flexibility is not possible with the BCM. One reason for adopting CBGs as the area of analysis was to render the model independent of any carrier's network architecture. PacTel's model, therefore, does not offer any significant advantages over the BCM and its proprietary nature renders it much less appealing. Subject to further fine-tuning of the BCM's parameters and a "trueing up" of the results to actual data, TCG recommends that the Commission adopt the BCM as the initial cost model for these purposes.

The Notice also requests comment on the feasibility of employing auctions as a means of determining the amount of universal service support necessary in high cost areas. Auctions are generally complex undertakings and would require substantial oversight by the Commission and do not measure up very well next to the TSLRIC study for establishing the initial support level. They require more than one carrier eligible to bid (and preferably many more), which is not always guaranteed particularly in the early stages of local competition. Auctions also open the possibility for "gaming" the subsidy-setting process. Whereas only one cost study needs to be completed to determine the initial support requirements, auctions might have to be conducted relatively frequently to ensure that the subsidy is minimized. By contrast, once the initial funding level is

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level of study. In the event that costs do vary significantly within a wire center, a more narrow geographic area such as CBGs would be appropriate.

established using a cost study model, the Commission only needs to periodically review the rates offered by competing local telecommunications providers to establish a new funding requirement based on the average rates charged by providers in a service area. This is a relatively simple process and captures all of the information that a complex and costly auction would reveal. Such reviews could be completed as often as the Commission thought it necessary, as market conditions warrant. Auctions, by contrast, require a substantial commitment of Commission resources and should only be used in the unlikely event that a particular area may not be served at the study-determined support level.

C. Establishing the Initial Size of the Subsidy: Affordability and Separations[9]

With the nation's penetration rate for telephone service hovering in the vicinity of 94% of all households, one can consider the existing rates for basic service (as currently defined) as "affordable." TCG sees no reason to adjust existing rates, therefore, to some national benchmark level. TCG does believe that it is important to avoid over-burdening the Federal universal service program and that a proper balance is necessary between the Federal and state universal service programs, as envisaged by the Act.

In particular, the Carrier Common Line Charge ("CCLC")

[9]See Notice, paragraph 25 and paragraph 30.

should not be viewed as a universal service subsidy element. Rather, the CCC is simply one portion of the non-traffic-sensitive cost of local loops allocated to the interstate jurisdiction. In that sense, the CCC is no different than today's FCC subscriber line charge or state local exchange rates: it is just a way of recovering costs from users of local exchange facilities. Accordingly, no portion of the 25% of the general cost of the local loop subject to the federal jurisdiction should be recovered from the universal service fund.

Using TSLRIC as the proper cost methodology for assessing the size of the universal service fund will permit the Commission to spread the universal service funding burden equitably between the interstate and intrastate jurisdictions. Currently, those incumbent local exchange carriers whose embedded loop costs exceed 115% of the national average are permitted to allocate a greater percentage of the cost to the federal jurisdiction for recovery via the USF. The support amount is based on each ILEC's embedded costs and this support is available to the ILEC only and therefore this method perversely discourages efficiency. Because the new universal service mechanism will rely upon an independent estimate of the total service long run incremental cost of basic service, such perverse incentives are removed. Therefore, the new universal service mechanism can continue to utilize a graduated cost recovery scale (similar to the current scale), maintaining continuity and a balance of responsibility between the state and federal jurisdictions. TCG strongly recommends that the Commission and the Joint Board adopt this alternative, in concert with an independent cost estimate and equal access to the support fund by all eligible carriers.

D. Funding Universal Service[10]

The Act states that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."[11] The Act states further that "every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission.... The Commission may exempt a carrier or class of carriers from this requirement if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution ... would be de minimis."[12] Thus, any funding mechanism for universal service must be competitively neutral: no carrier should bear an unfair portion of the contribution burden.

The Act clearly mandates that the Federal universal service mechanism be supported by fair and equitable contributions from all interstate providers of telecommunications service. The most

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[10]See Notice, paragraphs 118-126.

[11]Sec. 254(b)(4).

[12]Sec. 254(d).

efficient alternative, therefore, is to assess each provider according to market share. In paragraphs 122-124 of the Notice, three alternative measures of market share are proposed: 1) gross revenue, 2) revenues net of payments made to other carriers, and 3) number of lines or minutes. TCG strongly recommends that the Commission adopt the second alternative. This measure, commonly referred to as "net transmission revenue," will most accurately capture the facilities-based market share of each carrier and will avoid unnecessary and unfair double-counting of any carrier's revenue.

The Act makes it clear, however, that a new entrant or a small incumbent may not have sufficient revenue to warrant contributing to the fund.[13] It would be unreasonable, of course, to expect a carrier to contribute to the support fund if such contributions would indeed have no significant impact on the contributions of any other carrier or the sustainability of the fund itself. Moreover, it would be unfair and contrary to the Act's goal of encouraging robust competition to require new entrants and startups to contribute to the fund from their already small revenue streams particularly given that new startup competitors often take time to even become profitable. TCG recommends, therefore, that the Commission adopt a threshold market share of at least 1% of interstate net transmission

[13]It is clear that Congress intended to exempt carriers where "the administrative cost of collecting contributions...would exceed the contribution where that carrier would otherwise have to make under the formula for contributions selected by the Commission. Joint Explanatory Statement.

revenue before a carrier is required to contribute to universal service funding.

E. Support Eligibility[14]

According to Sec. 214(e) of the Act, any carrier which offers service over its own facilities or over some combination of its own facilities and resale of another carriers' facilities throughout an area, and which advertises the availability of such services throughout the area, is eligible to receive universal service support. Furthermore, Sec. 254(e) mandates that all such support be "explicit." Two issues arise in the context of these sections: 1) the distribution method, and 2) the definition of the service territory.

A fundamental feature of the universal service mechanism envisaged by the Act is competitive neutrality. No carrier should be disadvantaged either by its obligations to contribute to the mechanism or through discrimination in its access to support from the fund. Furthermore, the universal service mechanism should rely as much as possible on the forces of competition to maximize efficiency and consumer choice. Key to these goals is a distribution mechanism that allows all customers, including subsidized customers, to take full advantage of the competitive choices available to them.

To achieve such goals, therefore, TCG recommends that the Commission distribute support to carriers via a credit to the

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[14]See Notice, paragraphs 41-49.

carrier for each customer that it serves who is eligible for support. That is, for each customer purchasing subsidized service, that customer's carrier would draw a credit from the fund on that customer's behalf. Implementing a credit system will ensure that all subsidy-eligible customers receive their subsidy regardless of which carrier they select. Furthermore, a system of credits will introduce competitive efficiency to the provision of universal service, minimizing the size of the subsidy and maximizing customer alternatives. The carrier's credit request should be submitted periodically and can offset the carrier's contribution liability, allowing the carrier to submit net contributions to the fund. As much as possible, the process should be automated to facilitate verification of carrier and customer eligibility, and to collect contributions and to disburse support funds.[15]

According to the Act, the states are responsible for establishing the size of the service territory for the purposes of qualifying for universal service support. To remain consistent with the Act's intent to foster full facilities-based alternatives for telecommunications services, these territories should not be so large as to force competitors to rely upon extensive resale of ILEC facilities to be eligible for support. One alternative would be for the universal service territory

[15]Although the Act expressly excludes the Lifeline Assistance Program from this new universal service mechanism, TCG recommends that each state adopt similar competitively neutral distribution mechanisms to govern support for Lifeline customers.

definition to be established in relation to the cost study areas since that is the most discrete level at which support can be computed and distributed. TCG, therefore, recommends that the service territory for universal service purposes be no larger than the wire center and no smaller than a Census Block Group. Such bounds will encourage facilities-based competition, will ensure that the service territory requirement does not constitute an unreasonable barrier to entry, and will best ensure that support-eligible customers have an opportunity to take service from a competitor.

F. **Administration of the Fund**[16]

Independent administration of the fund is critical to the success of this endeavor. While the administrator need not (and probably should not) have any policymaking or enforcement power of its own, the administrator will control a significant amount of money and information regarding market shares. Independence is essential to ensure fairness and confidentiality. The independent administrator will be responsible for 1) collection of carrier contributions; 2) disbursement of the USAF; 3) review and adjustment of the funding requirement; and 4) resolution of disputes regarding the fund.

As discussed in the Notice, the state regulatory commission could be one possibility for administration. While this is appealing in certain respects, the disadvantages outweigh the advantages: the administrator must have accounting skills, not regulatory experience; and civil service procedures may inhibit flexibility and result in less efficiency than a private organization would achieve. Furthermore, as regulator, the state commission will be the ultimate arbiter of disputes regarding the fund. The role of fund administrator would conflict with the state commission's primary responsibilities.

Another option is to create a quasi-governmental agency dedicated to the administration of the USAF. Although proper creation of a new organization would guarantee the fund's independence, it would be costly, time-consuming, and

[16]See Notice, paragraphs 127-131.

unnecessary. Conversely, existing quasi-governmental organizations (e.g., NECA), while perhaps less costly, lack the necessary independence.

A third option and, in TCG's view, the most promising, is to put the administration responsibility out to bid. A request for proposals, managed by the Commission, would give the Commission more options, and would solicit proposals from organizations possessing the requisite skills and qualifications: e.g., accounting firms, consulting firms, and financial management firms. Such firms have the necessary independence, the experience and the appropriate skills and computing infrastructure. By selecting a private firm with appropriate experience after the bid, the state guarantees that the administration of the fund will be accurate and efficient. The administration contract should be no longer than three years and the administrator's compensation should be part of the total funding requirement assessed on contributors to the fund.

G. Advanced Services for Schools, Libraries, Health Care Providers

At this time, TCG finds it difficult to discuss the issues related to provision of advanced services to schools, libraries, and rural health care providers because it is not yet clear what those services might be, when and how benefits will be realized, or how priority needs will be set. In many instances, the telecommunications needs of these entities can be addressed simply and affordably by a number of providers. Indeed, basic accessibility and connectivity should be the goal here as well. The Commission should avoid implementing policies that might lead to "gold-plating" of institutional telecommunications systems when a less expensive and more efficient service might suffice. And, as much as the latest telecommunications network services may appear to enhance education and health care, substantial human capital is essential to make such services effective and viable.

While the Act requires the Commission to address these issues now[17], it does not require the Commission to reach conclusions absent necessary information. The Commission may reasonably establish a Phase II for the purpose of assessing needs and the costs of meeting the needs of these organizations. This assessment of needs must be a practical and realistic undertaking, not a wish list. Bearing in mind that all costs are ultimately passed through to some subscribers somewhere, efficiency is an important criterion for supplying advanced services to any entity. TCG recommends that the Commission direct the states to develop specific proposals for the types of services that will truly improve the delivery of services to the public by eligible institutions. Based on this specific list of services, the Commission can formulate a list of special services that will be eligible for universal service support, as well as the appropriate discount structure.

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[17]The Act, Sec. 254(a)(2).

H. Universal Service and "Pay or Play" Approaches

In particular, it would appear that mechanisms that link interconnection rates with universal service responsibilities (so-called "pay-or-play" programs) are inconsistent with the Act.[18] Under the pay-or-play scheme, carriers are classified as "players," or "payors." Players are those carriers that assume a universal service "burden" similar to that borne by incumbent local exchange carriers (such as by providing service to residential customers, including lifeline service). For assuming that "burden," players pay a lower rate for interconnecting to the incumbent's network. Payors, on the other hand, pay a higher rate for interconnection, allegedly to compensate the incumbent for bearing the competitor's universal service responsibility. However, pay-or-play is inconsistent with both the interconnection and the universal service provisions of the 1996 Telecommunications Act.

Pay-or-play results in two sets of rates, neither of which has been established to be in compliance with the specific costing standards of the Act. More critical, however, is that pay-or-play clearly discriminates against new entrants relative to incumbents. The statute mandates that all providers of

[18]On September 27, 1995, the New York Public Service Commission adopted pay-or-play as the state's universal service/interconnection mechanism. See, Case 94-C-0095, Order Instituting Framework for Directory Listings, Carrier Interconnection, and Intercarrier Compensation. Although TCG signed the agreement implementing the interconnection rates, we did so to move ahead with our business plans. TCG continues to believe strongly that even the "player" rates for interconnection in New York far exceed its costs.

interstate telecommunications services "...contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[Sec. 254(d)] According to the Conference report, "... the conferees intend that any support mechanisms continued or created ... should be explicit, rather than implicit as many support mechanisms are today." "Playing" implies that each carrier will provide its own internal, i.e., implicit, subsidies. Moreover, any carrier advertising throughout a state-designated area and willing to serve that entire area is eligible for universal service support from a source external to its revenues (Sec. 214). Furthermore, because implicit subsidies are neither "specific or predictable," pay-or-play would also violate Section 254(d). For these reasons, therefore, TCG recommends that the Commission rule that a pay-or-play and similar mechanisms are not consistent with the Act.